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IN THE

Supreme Court of the United States

No. 1014

October Term, 1941

CHARLES B. RAYNER,
Petitioner

v.

UNITED NORTH & SOUTH DEVELOPMENT COMPANY,
Respondent

BRIEF BY RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

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FIRM FOUNDATION—AUSTIN

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JURISDICTIONAL STATEMENT

The petition for writ of certiorari does not comply with the rules of this court (Rule 38, paragraph 2), which require a statement particularly disclosing the basis upon which it is contended that this court has jursidiction to review the judgment in question. The required jurisdictional statement is found only in the brief attached to the petition.

PRELIMINARY STATEMENT

At the outset, respondent calls attention to a recent Texas decision handed down since the opinion of the Circuit Court of Appeals in this cause, and submits that that decision is conclusive of the matters involved in this cause.

The record in this case shows that the Commonwealth of Massachusetts filed a suit in the State Court against Edgar B. Davis on a tax judgment secured in Massachusetts and as ancillary to that suit filed a garnishment suit against respondent as garnishee and secured a writ of garnishment against the stock of Davis in respondent corporation; that the garnishment writ was quashed and the Commonwealth of Massachusetts appealed from the judgment quashing the writ with only a cost bond and without a supersedeas bond. An appeal was also taken in the main suit and a supersedeas bond was filed therein. One of several reasons assigned by repondent for refusing to transfer the stock was that the garnishment suit was still pending in the appellate court and respondent was prohibited under the statutes from transferring the stock pending appeal. The trial court in this case was of the opinion that the quashing of the writ left respondent free to transfer the stock since no supersedeas bond was filed by Massachusetts on appeal in the garnishment suit.

During the trial and on appeal of this cause, it was not disputed that if the garnishment writ was

in force and effect at the time of the demand by Rayner for transfer of the stock, the corporation was justified in refusing to transfer it.

At page 30 of his brief filed in this court, in support of his petition for certiorari, petitioner makes the statement that "the Texas law clearly is that the entry of a judgment quashing a writ of garnishment and discharging the garnishee places all parties in the position they occupied before the writ was issued, and an appeal from the judgment will not restore the status quo or in any way prevent the parties from acting as though the writ had never issued, unless a supersedeas bond is filed."

No doubt the above statement by petitioner was written and printed before the recent Texas decision; otherwise, petitioner certainly would not have made such statement, particularly when he does not cite any authorities in support of his view. Although the Circuit Court of Appeals said "a reversal might lead to litigation in which the corporation would be invoked," it is noticeable that petitioner barely mentions the garnishment question in his application and brief, when it cannot be disputed that if the statutes of Texas restrained the corporation from transferring the stock, petitioner would not be able to recover in this action.

On February 18, 1942, after the decision of the Circuit Court of Appeals in this cause, the Court of Civil Appeals for the Third Supreme Judicial District of Texas at Austin, handed down decisions in

both suits. In Cause No. 9041, *Commonwealth of Massachusetts, et al* v. *Edgar B. Davis,* (opinion not yet printed), the court in upholding a judgment for Davis on his cross action for damages for wrongfully suing out the writ of garnishment, specifically held that the garnishment writ was in full force and effect pending the appeal despite the fact that the Commonwealth of Massachusetts had not filed a supersedeas bond. The court said:

> "In the instant case the impounding of the stock by garnishment did deprive appellee of its use, because our statute (Art. 4084) prohibits the sale or *transfer* of stock of a corporation impounded by garnishment, and provides that any sale or *transfer* of the stock is void. This is true even though the officer serving the writ does not in fact take possession of the stock, because the courts hold that under such a statute, the writ is still in force and effect, notwithstanding the writ has been quashed, and notwithstanding an appeal is taken on cost bond from the order quashing it, and *although no supersedeas bond is filed.* Mackenzie v. Englehard, 266 U. S. 1139. By the service of and continuing in force of the writ of garnishment, appellee has been deprived of the use of his stock in financing the development of the property which would have made the stock valuable, and the garnishment caused the stoppage of cessation *of* the development contracted for because those interested feared change in management of the corporation." (Italics ours).

Respondent submits, therefore, that this decision alone is sufficient to justify a denial of the petition

for certiorari. This shows that the Circuit Court of Appeals not only did not decide a question of local law in a way probably in conflict with applicable local decisions, but decided the question in complete harmony with an applicable local appellate court decision on the identical matter involved in this suit, that is, that the garnishment writ was in full force and effect at the time petitioner demanded a transfer of the stock and that the garnishment lien continued in effect pending appeal by virtue of the statute.

Respondent submits that nothing further need be said, but will discuss the issues in order to show the soundness of the judgment of the Circuit Court of Appeal.

SUMMARY

The record shows that for sometime prior to this litigation, Davis was making the contention that there was no consideration for the transfer of the stock by him to Rayner. H. M. Ainsworth, Vice President of the corporation, testified that he had discussed the matter with Davis "hundreds of times, as a guess." (R. 84). Respondent submits that the record clearly shows that Rayner knew that Davis was contending that there was no consideration for the notes before he demanded transfer of the stock. The record also shows (R. 100) that the Commonwealth of Massachusetts had filed a suit against Davis in the State District Court and had run a writ of garnishment on the stock of Davis in the corpora-

tion; that Davis and Rayner and other lien claimants on the stock of Davis were parties to this suit; that the garnishment writ had been quashed but the State of Massachusetts had appealed to the Third Court of Civil Appeals of Texas from both the garnishment suit and the main suit to which the garnishment suit was ancillary; that only an appeal bond was perfected by Massachusetts in the garnishment suit; that after the garnishment writ was quashed, Rayner and other parties claiming a lien on the stock, as well as Davis, agreed to dismiss their suit as to ownership of the stock *without prejudice* to all parties and allow the appeal of Massachusetts to proceed without their being parties. (R. 126). This left unsettled the question of the superiority of the liens claimed by Massachusetts and Rayner.

The record also shows that at the time of the sale of the stock by Rayner to himself at public sale, he was warned by Davis that the sale was invalid. (R. 50).

After the sale of the stock by Rayner to himself and after Rayner had demanded that the corporation transfer the stock to him, Davis, in addition to making oral protests with the corporation against transferring the stock, wrote a letter to the corporation, in which he said in part as follows:

> "I am notifying you and the directors that any transfer of this stock except upon a determination of the question of ownership between said Rayner and myself should only be made in a way that will protect the Company." (R. 87)

The officers of the corporation had no interest in the matter other than to do that which the law required them to do. What should they have done in the face of these facts? They saw that Rayner was claiming that the stock should be transferred to him. They saw that Davis was claiming that there was no consideration for the notes and pledge of the stock by him to Rayner and had warned the company not to transfer the stock. They saw that the Commonwealth of Massachusetts was claiming a lien on the stock by virtue of the writ of garnishment and statute and that the validity of this writ was on appeal. If they should transfer the stock to Rayner they knew that they would be taking a chance of having to reimburse either Davis or the Commonwealth of Massachusetts for the value of the same. Naturally, the officers of the corporation turned to its attorneys for advice which they followed and thereupon wrote a letter to Rayner, as follows:

"UNITED NORTH & SOUTH DEVELOPMENT CO.
LULING, TEXAS
November 8, 1940

Charles B. Rayner, Esq.
Scarbrough Building
Austin, Texas

Dear Mr. Rayner:

This will acknowledge the receipt of your letter of November 1, 1940, received by us on November 2, 1940, with reference to the transfer of certain stock represented by certificates in the name of Mr. Edgar B. Davis.

We have taken this matter up with our attorneys who advise that we are prevented from making any transfer of the stock referred to in your letter for a number of reasons, among which are: there is still pending in the Courts of Texas, a certain suit styled the Commonwealth of Massachusetts versus Edgar B. Davis, in which said stock is involved and tied up; and that stock is subject to the final outcome of the Garnishment suit pending in connection with the above mentioned litigation; further, that the Court of original jurisdiction requires us to hold all stock standing in the name of Edgar B. Davis in status quo until the final termination of both causes.

Mr. Edgar B. Davis has advised us that the purported sale held by you in Austin, Texas, on October 18, 1940, where you claimed to purchase the stock, was entirely invalid; and that you were fully notified of the illegality of such action by due written notice duly delivered to you before you offered said stock for sale.

The Company has been specifically notified by Mr. Davis that you are not entitled to a transfer of said stock, and that he disputes your right to have the same transferred from his name.

You will please understand that this Company does not have the right nor is the duty imposed upon it to determine who owns stock, the title to which is in controversy, offered for transfer on its books.

The Company stands ready to make the transfer to you if you are the true owner but it feels justified in taking the position that it should be furnished with satisfactory evidence of the un-

disputed ownership of any such stock before transfer.

Yours very truly,

H. M. AINSWORTH

Vice-President and Treasurer."

(See R. 59)

We see, then, that the corporation based its refusal to transfer upon the warning by Davis, and specifically mentioned the garnishment appeal and the invalidity of the sale of the stock by Rayner to himself and "a number of reasons," which, under the state of the record, includes the question of lack of consideration for the notes and the pledge of the stock, or as stated in the letter from Ainsworth to Rayner that Davis "disputes your right to have the same transferred from his name."

The trial court in finding that the corporation was not justified in refusing to transfer the stock, based its finding wholly upon—

(1) the fact that Davis owned more than eighty percent of the stock;

The only witness examined on Davis' alleged domination of the corporation—viz., Ainsworth, Vice President, testified positively that Davis did not dominate him. (R. 93).

(2) the fact that the officers of the corporation

in previous garnishment suits had answered that the stock was pledged to Rayner;

> In the words of the Circuit Court of Appeals, "the fact that he (Ainsworth) or other officers of the Company had answered or admitted in garnishment proceedings that the stock was pledged to Rayner did not make them the judges of the validity of such a pledge."

(3) the appeal of the garnishment suit by Massachusetts without a supersedeas bond left the Company free to make the transfer;

> The officials of the corporation were advised by counsel, the good faith of which the trial court did not question (R. 203), that the appeal by Massachusetts against the quashing of the garnishment, even without supersedeas, had the effect of maintaining the lien in force. And the Texas Court of Civil Appeals so held on February 18, 1942.

The Circuit Court of Appeals held that

> "The sole question is as to whether or not the probable cause existed to justify the refusal of the transfer."

It concluded that the circumstances in this case

> "created a legal situation which the officers of defendant were not qualified to decide—they were entitled to rely on the advice counsel gave in good faith."

And that

> "While it (the writ of garnishment) had been quashed by the trial court and appealed without supersedeas, a reversal might lead to litigation in which the corporation would be involved."

And that

> "The officers of the appellant acted upon the advice of reputable counsel, and it cannot be said that they were arbitrary or that the right of plaintiff to have the transfer was free from doubt."

Respondent submits, therefore, that the findings by the trial court were not supported by the evidence and that the Circuit Court of Appeals properly reversed the cause.

THE WARNING BY DAVIS NOT TO TRANSFER THE STOCK

The opinion of the Circut Court of Appeals held, among other things, the following:

> "The sole question is as to whether or not the probable cause existed to justify the refusal of the transfer."

> "The fact that * * * officers of the company had answered or admitted in garnishment proceedings that the stock was pledged to Rayner did not make them the judges of the validity of such a pledge."

"The officers of the appellant acted upon the advice of reputable counsel, and it cannot be said that they were arbitrary or that the right of plaintiff to have the transfer was free from doubt."

"They were entitled to rely on the advice counsel gave in good faith."

The above holdings of the Circuit Court of Appeals are in line with the rulings of all courts, towit, that a corporation, acting in good faith, may always refuse to make a transfer of stock where it has reasonable grounds for so doing, and especially where it has been warned by the holder of record not to make the transfer, and a garnishment writ and judgment quashing same is on appeal. Refusal under such circumstances does not constitute conversion.

AUTHORITIES

Makenzie v. Engelhard, 266 U. S. 131, 69 L. Ed. 205
People v. Elgin Motor Corporation, 208 Ill. App. 601, (Ill. Sup. Ct.)
Cox v. Republic National Company, 112 S. W. (2d) 300 (Tex. C.C.A. writ of error dismissed)
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Corn Exchange Nat. Bank v. Kaiser, 160 Wis. 199, 151 N. W. 259
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Leurey v. Bank of Baton Rouge, 131 La. 30, 58 So. 1022
Nagel v. Ham, Yearsley and Ryrie, 152 Pac. 520
Livezey v. N. Pac. Ry. Co. 27 Atl. 379
Thompson on Corporations (3rd Ed.) Section 4433
14 Corpus Juris, p. 759, Section 1159
Thompson on Corporations (3rd Ed.) Section 4344

In *Shear Co.* v. *Wilson*, 292 S. W. 531 (Tex. Com. App.) the court had under consideration the validity of a transfer of certificates of stock alleged to belong to a Mrs. Wilson but standing in the name of another person after the officers of the corporation had notice of Mrs. Wilson's claim thereto. The transfer was made without Mrs. Wilson's authorization and after notice of her claim of equitable title. The court

in its opinion stated and applied the legal principles involved as follows:

> "Now it cannot be doubted but that, in the absence of notice to the contrary, the corporation in the matter of transferring its shares would be fully justified in acting upon the presentation of such certificate properly endorsed by the record holder of the legal title to the shares represented. Upon the plainest principles of justice, notice that another than the one presenting is the equitable owner of the shares would preclude the corporation from making the reissue upon the penalty of liability as for a conversion upon the real owner's suffering a loss."

> "* * * The contention is that under the well-recognized rules facilitating the use of stock certificates as commercial paper, the corporation was authorized to treat C. W. Wilson, the holder under a blank endorsement of a prior legal owner, as the real owner. This, of course, is true in the absence of notice to the contrary, but presumptions, however wholesome, will not be indulged contrary to the known facts. There is no question of an innocent person's suffering or of estoppel. It is purely a question of the corporation's issuing Mrs. Wilson's stock to another, after notice that it belonged to her."

The court in the above cause cites *Bayard* v. *Bank*, 52 Pa. St. 235, in which case it is stated as follows:

> "That a bank or other corporation, and also

these defendants, are trustees to a certain extent for stockholders—that is, for the protection of individual interests—cannot be denied. They are alike trustees of the property and of the title of each owner. They have in their keeping the primary evidence of title, and they are justly held to proper diligence and care in its preservation. From this it results that they may rightfully demand evidence of authority to make a transfer before they permit it to be done. Their own safety required that they be satisfied of right of the person proposing to make a transfer to do what he proposes. Generally, sufficient evidence of such right is found in the possession of legal titles to the stock. Yet it is well settled that it is not in all cases sufficient, notwithstanding that the true equitable ownership may be in some other than the holder of the legal right, and the transfer may be a gross wrong to such an equitable owner. To that wrong the corporation or keepers of the register make themselves parties, if, with knowledge that there is no equitable right to transfer, they permit it to be done."

Whether or not there was adequate consideration for the notes given Rayner by Davis is not an issue in this case. "The sole question," as stated by the Circuit Court of Appeals, "is as to whether or not the probable cause existed to justify the refusal of the transfer."

The evidence shows that on a previous occasion Davis had made a gift to Rayner of $100,000.00 even though Rayner did not admit that it was an actual gift. (R. 194-195). The trial court said:

> "It is common rumor all over this country that when Davis sold out his original holdings that he gave money to everybody and everything; but I don't think it has anything to do with this case." (R. 195).

Ainsworth, Vice President, testified:

> "He (Davis) always called it a gift every time he talked to me about it." (R. 84)

and that they had discussed the matter

> "hundreds of times as a guess." (R. 84).

Caylor testified he knew of the controversy between Davis and Rayner. (R. 134).

We call attention to this matter for the reason that the officers of the corporation were in a position to know of the generosity of Mr. Davis, and that when he told them that the notes to Rayner constituted a gift, they had good reason to believe it.

Since Davis was not a party to the suit, the reasons which actuated him in keeping alive evidences of a gift instead of filing suit to attack the validity of the notes and pledge of stock were not gone into, and no conclusion can be drawn therefrom as petitioner attempts to do.

We submit that the Circuit Court of Appeals was correct in pointing out that controversies "as to whether they were donations or had any considera-

tion" "may or may not in a proper proceeding have merit." The Circuit Court of Appeals expressed the view "that the appellee should be relegated to either a mandamus, an injunction, a suit for specific performance or other proceedings, *in which the title to the stock can be determined.*" (Italics ours).

Respondent submits that a reading of petitioners' brief at pages 17 and 18 shows that there was no consideration for the notes given by Davis to Rayner. Petitioner parted with nothing and did not agree to part with anything. The facts stated show on their face that it was simply an act of generosity on the part of Davis, just as it was when there was no liability on the part of Davis to pay Rayner the $100,000.00 he gave him on another occasion. (R. 194-195).

Petitioner's main argument that there was consideration for the notes is based upon the fact that the original notes had been renewed and Davis had acknowledged the debt in several letters. But this was not sufficient consideration to estop Davis from claiming there was no consideration for the notes in the hands of Rayner. This is clearly held in *Hunter* v. *Lanius*, 82 Tex. 677, 18 S. W. 201. The rule is stated in 8 *Corpus Juris* 444 as follows:

> "As between the original parties, and as against transferees who are not bona fide purchasers for value, a renewal note is open to all defenses which might have been made against the original note, at least in so far as they re-

> late to consideration, such as want or failure of consideration, fraud, usury, gambling debts, or other illegality. * * * "

The rule is again stated with reference to a failure of consideration in 8 *Corpus Juris* 751 as follows:

> "Where a note is executed to a payee only in renewal of a prior note given to him, the real consideration for which it is given is that for which the prior note was given, and the failure of the same may be pleaded in an action on the latter note. * * * "

But regardless of the question as to whether the notes were based upon a consideration, the corporation was justified in refusing to transfer the stock as the officers thereof acted in the good faith belief that a bona fide controversy existed between Davis and Rayner as to whether there was any consideration.

We again call attention to the second paragraph of the quotation from the Texas case of *Shear* v. *Wilson*, supra, where the court said:

> "It is purely a question of the corporation's issuing Mrs. Wilson's stock to another, after notice that it belonged to her."

In the case now before this court, not only did the officers who acted for the corporation have a specific warning from Mr. Davis with reference to the controversy between him and Rayner, but the officer who

acted for the company (Colonel Ainsworth) had had an intimate knowledge of the facts of the controversy from many and repeated conversations with the parties involved. This officer also acted on the advice of counsel as to the effect of pending writ of garnishment.

Respondent respectfully submits that the Circuit Court of Appeals was right, and we again quote from its opinion, when it said:

> "The sole question is as to whether or not probable cause existed to justify the refusal of the transfer."

INVALIDITY OF THE SALE OF THE STOCK

One of the reasons specifically assigned by the corporation in its letter to Rayner refusing to transfer the stock was that Davis claimed that the sale of the stock from Rayner to himself was invalid.

The Circuit Court of Appeals in speaking of this matter, says:

> "This created a legal situation which the officers of defendant were not qualified to decide."

Respondent submits that the sale of the stock by Rayner to himself was in fact invalid.

AUTHORITIES

In Re Thompson, 276 Fed. 313 (U.S.D.C.) affirmed, 284 Fed. 65 (CCA) Certiorari denied 260 U.S.
Dibert v. D'Arcy, 154 S. W. 1115 (Mo.)
King v. Sullivan, 92 S. W. 51 (Tex. CCA)
33 Tex. Jurisprudence, Sec. 24, page 710

The stock was sold by Rayner to himself for $1.00 per share (R. 49). He filed this suit a few days thereafter and alleged its value to be $10.00 per share and recovered judgment for the sum of $8.05 per share. One officer of the corporation testified (R. 136) that the stock was worth about $3.50 per share and another officer testified (R. 155) that he estimated the stock to be worth not more than $5.00 per share.

It is thus seen that the officers of the corporation could have easily believed that there was a bona fide question raised by Davis as to whether Rayner had sold the stock for an inadequate consideration. Respondent believes that under the evidence, Davis in a suit brought by him, could set aside the sale for the reason that Rayner in making a sale of the property was acting as a trustee for Davis and it was his duty to procure the best price he could for the stock. It is clear that in making the sale of stock for $1.00 per share he violated his trust and thereby rendered the sale invalid, and, of course, if the sale was invalid, he has no right to recover in this action.

It was only necessary for the officers of the corporation to believe that a bona fide controversy existed between the three parties over this matter and if so, they were justified in refusing to transfer the stock.

Respondent respectfully submits that the Circuit Court of Appeals was right, and we again quote from its opinion with reference to this matter, when it said:

> "This created a legal situation which the officers of the defendant were not qualified to decide."

THE GARNISHMENT QUESTION

Another reason specifically assigned by the corporation in its letter to Rayner refusing to transfer the stock was that it had been advised by its attorneys that it was prohibited from doing so on account of the pendency of the garnishment suit by Massachusetts to garnish the stock of Davis in the corporation.

At the time of the trial and at the time of the decision of the Circuit Court of Appeals there was no Texas decisions exactly in point on this question. As pointed out in our Preliminary Statement herein, the decision of the Court of Civil Appeals for the Third Supreme Judicial District of Texas did not decide this identical question until February 18, 1942. But the Circuit Court of Appeals in this case,

while not directly passing upon the question as to whether the lien of garnishment was in force pending appeal without a supersedeas bond, did agree with respondent that regardless of the law on this question, the uncertainty of the law was a sufficient ground to justify a refusal to transfer the stock. The Circuit Court of Appeals said with reference to the garnishment writ:

> "While it had been quashed by the trial court and appealed without supersedeas, a reversal might lead to litigation in which the corporation would be involved."

Article 4084, *Revised Civil Statutes of Texas*, 1925, provides as follows:

> "EFFECT OF SERVICE OF WRIT.—From and after the service of such writ of garnishment, it shall not be lawful for the garnishee to pay to the defendant any debt or to deliver to him any effects; nor shall the garnishee, if an incorporated or joint stock company in which the defendant is alleged to be the owner of shares or to have an interest, permit or recognize any sale or transfer of such shares or interest; and any such payment or delivery, sale or transfer, shall be void and of no effect as to so much of said debt, effect, shares, or interest as may be necessary to satisfy the plaintiff's demand."

It is to be noticed that the Texas Court of Civil Appeals in the recent opinion held that by virtue of the above statute, the garnishment lien of the

Commonwealth of Massachusetts continued during the appeal of the garnishment suit.

Respondent submits that it is clear under the Texas statute that the stock could not be transferred pending appeal. *Revised Civil Statutes of Texas*, 1925 Art. 4084; *Humble Oil & Refining Company* v. *Andrews*, 285 S. W. 894 (Tex. CCA—writ of error refused by Texas Supreme Court). The conditions of attachment and garnishment bonds are identical, *Revised Civil Statutes of Texas*, 1925, Arts 279 and 4077.

The original garnishment bond kept the lien in force pending appeal, *Revised Civil Statutes of Texas*, 1925, Art. 4077.

The garnishment suit should not have been disposed of until the main suit had been determined. *Bergman* v. *Bank*, 141 S. W. 154 (Tex. CCA); *State Bank* v. *First National Bank*, 228 S. W. 268 (Tex. CCA).

The judgment quashing the writ of garnishment was not of such a nature that it could have been superseded. *Revised Civil Statutes of Texas*, 1925, Art. 2270; *Houtchens* v. *Mercer*, 119 Tex. 431; *Davis* v. *State*, 257 S. W. 1099 (Tex. Ct of Crim App); *MacKenzie* v. *Engelhard*, 266 U. S. 131; *King* v. *Watson*, 117 Pac. 165; *Rich* v. *Conley*, 64 N.Y.S. 33.

The effect of the judgment was to take nothing and

since there was nothing to supersede, it would be useless to file a supersedeas bond.

Under the Texas law, an appeal destroys the finality of a judgment. *Ry. Co.* v. *Jackson*, 85 Tex. 608; *Waples-Platter Gro. Co.* v. *T. & P.*, 95 Tex. 486; *Houston Oil Company* v. *McCarthy*, 245 S. W. 651 (Tex. Comm. of App.); *Hinton v. Uvalde Paving Co.*, 118 S. W. (2d) 317 (Tex. CCA—writ of error refused by Supreme Ct.); *Cooper* v. *Decker*, 21 S. W. (2d) 70 (Tex. CCA).

The service of the writ of garnishment in this case immediately created a lien on the shares of stock of Edgar B. Davis in favor of the Commonwealth of Massachusetts. This lien was maintained by virtue of the appeal bond during the pendency of the suit and the judgment by virtue of the appeal, and, as set out by the above authorities from the Supreme Court of Texas, was deprived of its finality. Therefore, the garnishee (respondent herein) could never offer the judgment in bar against a suit by the State of Massachusetts, garnishor, if the United North & South Development Company, garnishee, had transferred the stock to Rayner, petitioner herein, upon his demand during the pendency of the appeal.

Respondent respectfully submits that even before the recent decision by the Texas Court of Civil Appeals, it is clear that under the statutes of Texas providing for a garnishment bond, it was not neces-

sary for the Commonwealth of Massachusetts to file a supersedeas bond on appeal from the judgment quashing the garnishment writ, but that the lien continued in full force and effect pending the final determination of the cause. The recent decision in Texas has definitely settled this point.

Again we are unconcerned as to whether the law actually left the corporation free to transfer the stock. It is clearly shown that even if the contention of respondent is not correct that it was not necessary to supersede the judgment in order for Massachusetts to keep its lien in force, there is at least strong argument for this contention and without question a doubt as to the status of the decisions prior to the recent Texas decision. Therefore, under these circumstances, the officers of the corporation had a right to believe the good faith advice given by its counsel that the garnishment appeal prohibited the transfer of the stock. We again call attention to the doubt in the trial court's mind wherein it was said (R. 202) "I am inclined to think under the Texas statutes and decisions that it could have been superseded." But the trial court did not have the benefit of the recent Texas decision.

We further call attention to the statement of the trial court in its opinion (R. 203) wherein the court stated that he would not attribute bad faith to the attorneys who advised the officers of the corporation.

If the trial court himself had some doubts as to

the law in this matter and would not attribute bad faith to counsel who advised the officers of the corporation, and in view of the fact that there was no definite authority in the State of Texas at that time on this question, respondent respectfully submits that the Circuit Court of Appeals was right, and we again quote from its opinion, when it said:

> "While it (garnishment writ) had been quashed by the trial court and appealed without supersedeas, a reversal might lead to litigation in which the corporation would be involved."

But the recent Texas decision has removed all doubt on the matter.

OTHER GROUNDS FOR REFUSAL TO TRANSFER

In its opinion, the Circuit Court of Appeals said:

> "The effect of the judgment appealed from is to change the status from that of stockholder to a creditor, with the right to participate with other creditors in event of the liquidation or insolvency of the corporation. This should not be done except in a very clear case."

In this connection, we call attention to the fact that the record clearly shows that the corporation had no surplus funds (R. 135-136-153). See especially plaintiff's Exhibit No. 28. (R. 184-186). An

analysis of all these figures showed that the corporation lacked more than $67,000.00 to meet its current liabilities for wages, taxes, and other current requirements. If the judgment of the trial court had been sustained, its effect would have required the United North & South Development Company to purchase 11,709 shares of its stock, and be required to pay therefor the sum of $94,257.45 and to change the position of Rayner from that of a stockholder to a creditor.

It is the general rule that a corporation cannot purchase or acquire its own stock unless the acquisition is in good faith and the rights of the stockholders and creditors are not impaired. 19 *C.J.S.* p. 387, Sec. 950. *Thompson on Corporations* (3rd Ed.) Sec. 4081.

There is a minority rule that goes further and holds that generally a corporation has no power to purchase shares of its own stock. 19 *C.J.S.* p. 388, Sec. 950; *Thompson on Corporations*, (3rd Ed.) Sec. 4082; 13 *Texas Law Review* 442.

The cases in Texas are agreed that Texas corporations cannot purchase or acquire their own stock if there is prejudice to the rights of creditors or other stockholders.

When boiled down, the above rules really mean that a corporation cannot purchase its own stock, except out of its surplus funds. For it to do otherwise

would prejudice the rights of creditors and other stockholders.

Robertson v. L. Nicholes Company, Inc., 253 N. Y. Sup. 76, 141 Misc. 660
In Re S. P. Smith Lumber Co., 132 Fed. 618 (D. C. N. D. Texas).
Medical Arts Building Co. v. Southern Finance & Development Co. (C.C.A. 5th), 29 Fed. (2d) 696.

Respondent submits that the Circuit Court of Appeals was right, and we again quote from its opinion, when it said:

> "The effect of the judgment appealed from is to change the status from that of stockholder to a creditor, with the right to participate with other creditors in event of the liquidation or insolvency of the corporation. This should not be done except in a very clear case."

RAYNER HAS PURSUED WRONG REMEDY

The Circuit Court of Appeals concluded its opinion with the following statement:

> "It is our view that the appellee should be relegated to either a mandamus, an injunction, a suit for specific performance or other proceeding, in which the title to the stock can be determined."

To deny Mr. Rayner's recovery for conversion

would not do him the slightest injustice. If the sale is valid, then he has a right to bring suit against the corporation to compel it to make the transfer and to make Mr. Davis a party to the suit. If he does not make Mr. Davis a party to the suit, then in such suit the company itself would have a right to bring him in so that they might set up their claims and have their rights adjudicated in the same suit and thereby protect itself against their claims. But Mr. Rayner, within a period of approximately one month after the company refused to transfer the stock, brought a suit in the United States District Court instead of bringing a suit against Mr. Davis or a suit for mandamus against the corporation. The corporation could not implead Mr. Davis in this suit, because both he and Rayner were citizens of the State of Texas and to implead Mr. Davis in such suit would destroy the jurisdiction of the court. But independently of that question, this was a suit for conversion and Davis could not be made a party to it because if the company was not guilty of conversion, there could be no recovery against it, and if it was guilty of conversion, it could have no recovery over against Davis, and Davis could not be made a party to the suit. However, Mr. Rayner could have brought a suit in the State court for mandamus to compel the company to transfer the stock and could have impleaded Mr. Davis, or the company could have impleaded Mr. Davis. Mr. Raynor was also, at one time, a party to the garnishment suit, as well as Mr. Davis, but by agreement of those parties, all relief sought in the garnishment

suit as between the parties, other than Massachusetts and United North & South Development Company, was dismissed without prejudice to the rights of the parties to determine this matter in future proceedings. (R. 126).

It seems to us, therefore, that every sentiment of right and justice would require that Mr. Raynor be denied recovery for conversion. He failed to bring the suit that he should have brought in the first instance, and if he is now entitled to recover, he will in effect become a secured creditor of the corporation. We submit that it was the duty of the company, under the circumstances, since it believed in good faith that it would act at its peril in transferring its stock to refuse the transfer until the adverse claims could be determined; that it acted in the utmost good faith by seeking the advice of counsel; that the advice it received from counsel was correct and made in good faith, and as found by the court not to be in bad faith. However, regardless of the correctness of the advice of counsel, if the corporation acted in good faith in believing that a bona fide controversy existed as to whether the notes and transfer of stock to Rayner by Davis was merely a promissory gift, the officers of the corporation would have been derelict in their duty if they had transferred the stock and would have been grossly negligent if they had done so in the face of the advice of counsel that they were not authorized to do so. What greater evidence of good faith could be shown?

It is stated in *Howe* v. *Roberts*, 95 So. 344, by the Alabama Supreme Court, that a "suit in equity is the surest, most complete and most just remedy for compelling a corporation to register a transfer of stock and for adjusting the various conflicting rights or claims of other parties. It is a remedy applicable to almost all cases arising under a refusal of the corporation to allow a registry of transfers."

Respondent respectfully submits that the Circuit Court of Appeals was right, and we again quote from its opinion, when it held:

> "It is our view that the appellee should be relegated to either a mandamus, an injunction, suit for specific performance or other proceeding, in which the title to the stock can be determined."

ANSWER TO EACH GROUND ALLEGED BY PETITIONER

With the above facts and authorities in mind, we will now briefly reply separately to each ground stated by petitioner in his petition for writ of certiorari.

GROUND 1 (a) (Page 5 of Petition)

Petitioner contends that the Circuit Court of Appeals refused to follow the law of Texas in holding that the refusal of a corporation to transfer stock

properly endorsed for transfer gives the party seeking the transfer an option to sue for conversion or to bring a suit for mandamus.

The stock even if "properly endorsed" was subject to a *conditional* assignment, of which the corporation had ample notice and which petitioner held, and further the "proper endorsement" of stock did not release it from the writ of garnishment. The mere request to transfer stock "properly endorsed" could not nullify this legal impediment.

Petitioner cites three Texas cases in all of which the Court found that the refusal to transfer was without adequate cause. The Circuit Court in the instant case held that the refusal to transfer was for several good and adequate reasons. Obviously, the instant case is distinguished from each of the three cases cited. No Texas case has held that a refusal to transfer on the ground that a good faith controversy exists between the parties with reference to the ownership of the stock constitutes a conversion of the stock giving rise to an action for damages.

GROUND 1 (b) (Page 6 of Petition)

Petitioner contends under the above ground that "under Texas decisions, the good faith of the defendant is no defense in an action for damages for conversion where only actual damages are sought."

This statement of the petitioner is based on the presumption that there was actual conversion, whereas conversion arises only where a corporation refuses to transfer without some bona fide reason or justifiable cause.

Good Faith was not the only defense offered by respondent for its refusal to transfer the stock but was relied on separately and in connection with several defenses, i.e.: 1. That there were three claimants to the stock—the State of Massachusetts under a statutory garnishment writ and lien, the petitioner, and Edgar B. Davis, the record owner of the stock. 2. The garnishment was then on appeal which the Texas Court of Appeals recently has held was valid and sufficient to maintain the garnishment and the statutory lien in full force. 3. Respondent had been notified by Edgar B. Davis in writing and verbally that he claimed the stock and not to transfer same to Petitioner. 4. Reputable attorneys had advised the corporation on reasonable grounds that it should not transfer the stock, but to do so only when someone presented good evidence of clear title. The holding of the Circuit Court of Appeals is that there was a "good faith" controversy between the petitioner Rayner and Edgar B. Davis, which alleged controversy was as to the title to the stock at the time it was presented for transfer. Under the decisions, both in Texas and elsewhere, the corporation did not have to sit as a court to try this controversy.

Petitioner cites the case of *Pecos Ry. Co.* v. *Porter*, 183 S. W. 98. This was a suit brought against the railroad for refusal to deliver a carload of household furniture on tender of less than the full amount of freight. In that case it was held that the good faith of the railroad in refusing to deliver the furniture did not affect the plaintiff's right to actual damages for the conversion of the furniture to which he had the undisputed title. That case did not involve a situation where one party had adverse title to the property and where there were two other claimants one of which was asserting a statutory lien against it.

GROUND 1 (c) (Page 6 of Petition)

Under this ground petitioner contends that under Texas decisions a corporation may be called upon to decide "technical legal issues" or run the risk of being held for conversion of stock for refusal to transfer. This is clearly *not* the law in Texas.

The only case cited by appellant to sustain this theory of the law which is not sustained by decisions of either Texas or any other state, is *Rio Grande Cattle Co.* v. *Burns, Walker & Co.*, 82 S. W. 50, which merely holds that where the grounds on which the transfer is refused do not show any controversy over the title to the stock or relate to any such controversy, that the refusal is groundless and therefore constitutes a conversion. Here again pe-

titioner assumes that the Circuit Court of Appeals held that the refusal was groundless when in fact the Court held the opposite.

The points on which respondent refused to transfer the stock were not only "technical legal issues" but they are sound common sense reasons, which the Circuit Court of Appeals held justified the refusal to transfer the stock. No decision is presented where any corporation has been held liable because it failed to decide the outcome of a writ of garnishment or attachment pending in a court of competent jurisdiction at the very time request for transfer was made. The Petitioner had been a party to that very suit.

GROUND 1 (d) (Page 7 of Petition)

Under this ground petitioner contends that "under Texas decisions the corporate fiction will be disregarded where necessary to prevent fraud," and he relies solely upon the fact that because Davis owned a majority of the stock he dominated the officials of the corporation.

The only witness examined at the trial (viz., Ainsworth, Vice President) on the question of Davis' domination of the corporate officials testified that Davis 'did not tell him what to do'. (R. 93).

The Circuit Court of Appeals on sufficient

grounds found that Respondent was justified in refusing to transfer the stock, thus eliminating the question of fraud. There was no evidence of fraud. The mere fact that Edgar B. Davis owned more than fifty per cent of the stock in the corporation does not show domination or fraud. There being no evidence of fraud, it was unnecessary to "disregard the corporate fiction". That is immaterial in this case.

GROUND 1 (e) (Page 8 of Petition)

Under this ground Petitioner contends that "under Texas decisions petitioner, a pledgee of stock properly endorsed for transfer, had the right to have the same transferred on the books of respondent corporation, irrespective of whether or not there had been a foreclosure of the pledge lien."

Petitioner evidently did not believe that the endorsement of the stock was sufficient grounds on which to demand transfer because he undertook to foreclose under the purported assignment which he held, and this Respondent contends that that very foreclosure was invalid and Davis so advised the corporation. Petitioner admits the existence of a conditional assignment and made an attempt to foreclose under it. The question of consideration for the pledge is yet an undecided issue in the case and the Circuit Court of Appeals so said.

GROUND 2 (a) (Page 9 of Petition)

Under this ground petitioner contends that a "corporation must decide the technical legal issue and must decide it correctly," and cites the case of *London, Paris and American Bank* v. *Aranstein*, 117 Fed. 601, cest den 187 U. S. p. 641.

In that case the "technical legal issue" was not involved in suits actually pending in the courts at the time of the request for transfer, while in the instant case title to the stock was tied up in the garnishment suit then pending in the Texas Court of Civil Appeals, which has just recently decided the question as contended for by Respondent. Moreover, in the instant case the party demanding transfer had been a party to that pending suit, though dismissed without prejudice.

Furthermore, any decision by the corporation on this legal point, in the words of the Circuit Court of Appeals, "might lead to litigation in which the corporation would be involved" owing to the several claimants to the stock.

GROUND 2 (b) (Page 9 of Petition)

Under this ground petitioner contends that a corporation, if confronted with conflicting claims to stock and a demand for its transfer, should initiate some type of suit to determine title to the stock.

The case of *O'Neil* v. *Walcott Mining Company*, 174 Fed. 527 cited by petitioner, shows that a corporation "cannot assume the functions of a court and by their determination conclude the rights of the parties." The garnishment matter was already involved and then pending in a court of competent jurisdiction in which case petitioner had filed an interpleader and was awaiting the final decision. Of course this respondent could not assume functions of a court and oust the Texas Court of Civil Appeals of its jurisdiction.

In answer to the quotation out of the above case cited by petitioner that

> "the corporation when it refuses, and upon trial of the issue the court must be able to see from the facts established that *there was some question to be tried.* The mere claim of stock is not sufficient." (Italics ours).

we point out that the garnishment was then pending and therefore there was a "question to be tried" and it was at that very time being tried. The mere claim of *petitioner*, to employ the language of the decision cited, was not sufficient. The petitioner did not file any suit of any character to clarify the situation, and respondent contends that two suits involving the title to the stock had already been filed and were pending — Massachusetts v. Davis and the ancillary garnishment suit, Massachusetts v. United North and South Development Company (this respondent), to which petitioner had been a

party dismissed without prejudice. Respondent could not have maintained another suit to try out an issue already before the courts.

GROUND 3 (a) (Page 10 of Petition)

Under this ground petitioner contends that "the general rule is that a corporation, if confronted with conflicting claims to certain stock and a demand for its transfer, must either file an interpleader suit to get the question decided, get the adverse claimant to file some character of suit that will get the question decided, or transfer the stock to the first claimant."

This contention of petitioner is answered under Ground 2 (b).

GROUND 3 (b) (Page 11 of Petition)

Under this ground petitioner contends that "the general rule is that a corporation refusing to transfer stock must notify the party seeking the transfer of the reasons for its refusal, and that any reason not assigned at that time is waived and cannot be set up thereafter."

The corporation did notify petitioner of its reasons for not transferring the stock by letter and verbally, and certainly if any one was waived all of the reasons given by the letter to petitioner Ains-

worth, and shown by testimony as having been conveyed to petitioner, were not waived; but all of them were set forth by the written evidence and oral testimony in this case. The letter to Rayner stated there were "a number of reasons" and Rayner knew the other reasons, as well as those specifically set out.

GROUND 3 (c) (Page 11 of Petition)

Under this ground petitioner contends that "the authorities cited by the Circuit Court of Appeals do not sustain its decision."

The case of *Shear Co.* v. *Wilson*, 292 S. W. 531 (Tex. Comm. of App.) a case cited by the Circuit Court of Appeals, correctly holds that where a corporation issues stock of one person to another person who fails to show title to the stock, it is responsible. We contend petitioner did not show title to the stock presented by him for transfer, and if respondent had transferred same, it would have been liable.

In reference to *Howe* v. *Roberts*, 209 Ala. 80, cited by the Circuit Court of Appeals, respondent contends that since the Texas Court of Civil Appeals has decided that the garnishment lien continued in effect pending appeal, there is no longer any doubt that Rayner is limited to some other suit to secure a transfer of the stock. If he should be successful in showing clear title to the stock, he will

not be damaged in any way, especially since the stock advanced in value from $1.00 per share at the time petitioner purchased it under his purported foreclosure in October, 1940 to $10.00 per share testified to by petitioner as being the true value at the trial of this cause in June, 1941.

CONCLUSION

This suit is a suit for conversion. When a corporation refuses to transfer stock for justifiable reasons, it is not guilty of conversion. The sole question to be decided in this case is, to use the language of the Circuit Court of Appeals,

> "whether or not the probable cause existed to justify the refusal of the transfer."

The corporation's position was that the stock offered for transfer was involved in a controversy to which Davis, Rayner, and the Commonwealth of Massachusetts were all parties, and that suits were then pending in courts of competent jurisdiction in which title to the stock was an issue. The corporation officials had long known that controversies existed between Davis and Rayner and others as to whether the notes were a gift, and their attitude toward transfer of the stock to Rayner was influenced by knowledge that controversies actually existed, rather than whether the controversies had merit—question not properly before the court since Davis was not a party. These claims, including the

claim that the sale of the stock to Rayner was invalid, "created a legal situation which the officers of defendant were not qualified to decide"—in the words of the Circuit Court of Appeals, and on this matter "the officers of the appellant acted upon the advice of reputable counsel, and it cannot be said that they were arbitrary or that the right of plaintiff to have the transfer was free from doubt"—again quoting the Circuit Court of Appeals.

The position of the corporation officials was that appeal from the quashing of the garnishment on appeal bond, continued the writ in force and effect, and in this position they have been upheld by the recent decision of the Texas Court of Civil Appeals. Moreover, the Circuit Court of Appeals pointed out that "a reversal might lead to litigation in which the corporation would be involved."

Respondent therefore respectfully submits that the petition for certiorari should be denied for the following reasons:

(1) The corporation did not convert the stock, because "probable cause existed to justify refusal of the transfer" due to a long-existing controversy as to whether stock was a gift, the alleged invalidity of the sale of the stock by Rayner to himself, and the pendency of the garnishment suit prohibiting the transfer;

(2) A judgment in favor of petitioner would in

effect change the status of Rayner from a stockholder to a creditor.

Respectfully submitted,

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